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What are the FIVE "C's" of CREDIT?

Banks are not charitable institutions. They are in business to make (not lose) money. So, when a bank lends money it wants to ensure that it will get paid back! To maximize the possibility of being paid back, the bank wants to make sure that the borrower can pay back a loan and that such obligations have been met before. The bank must consider the five "C's" of credit each time it makes a loan.

Capacity

Capacity refers to your ability to repay the loan. The prospective lender will want to know exactly how you intend to repay the loan. The cash flow from the business, timing of the repayment, and the probability of successful repayment of the loan will be considered. Payment history on existing credit relationships—personal and commercial—is considered an indicator of future payment performance. Prospective lenders also will want to know about your contingent sources of repayment.*

Capital

Capital is the money you personally have invested in the business and is an indication of how much you have at risk should the business fail. Prospective lenders and investors will expect you to have contributed from your own assets and to have undertaken personal financial risk to establish the business before asking them to commit any funding. If you have a significant personal investment in the business you are more likely to do everything in your power to make the business successful. Banks will want to see what type of investment you plan to make in the business. In some cases, it may need to be at least 25 percent of the total amount needed to start your business.

Collateral

Collateral or "guarantees" are additional forms of security you can provide the lender. If for some reason, the business cannot repay its bank loan, the bank wants to know there is a second source of repayment. Assets such as equipment, buildings, accounts receivable, and in some cases inventory are considered possible sources of repayment if they are sold by the bank for cash. Both business and personal assets can be sources of collateral for a loan. A guarantee, on the other hand, is just that—someone else signs a guarantee document promising to repay the loan if you can't. Some lenders may require such a guarantee in addition to collateral as security for a loan.

Conditions

Conditions focus on the intended purpose of the loan. Will the money be used for working capital, additional equipment, or inventory? The lender will also consider the local economic climate and conditions both within your industry and in other industries that could affect your business.

Character

Character is the general impression you make on the potential lender or investor. The lender will form a subjective opinion as to whether or not you are sufficiently trustworthy to repay the loan or generate a return on funds invested in your company. Your educational background and experience in business and in your industry will be reviewed. Your credit report or credit score will also help the banker determine your character. (It may be a good idea to try and clean up any small outstanding issues on your credit report prior to seeking a loan.) The quality of your references and the background and experience of your employees also will be taken into consideration.

**Credit Issues - If you have had credit problems in the past, you may want to work with a Credit Counseling Service. These organizations help to get your finances in order, set up a budget, or arrange to pay accounts. They are often available at low cost. Contact the WI Dept of Financial Institutions 608-261-9555 to see if the organization is properly licensed in Wisconsin or visit www.wdfi.org/wca/consumer_credit/credit_problems.htm*